

Quarterly Disciplinary Review

October 2012

FINRA publishes this quarterly review to provide firms with a sampling of recent disciplinary actions involving misconduct by registered representatives. The sample includes settled matters and decisions in litigated cases (National Adjudicatory Council (NAC) decisions and SEC decisions in FINRA cases). These summaries call attention to, and remind registered representatives and member firms of, specific conduct that violates FINRA rules and may result in disciplinary action.

FINRA also provides detailed [disciplinary information and decisions](#) and a summary of [monthly disciplinary actions](#) on its website.

Sharing Commissions With an Unregistered Individual and Providing False Information to Firm

- ▶ FINRA settled a matter involving a registered representative who shared commissions with an unregistered person who operated a business out of the same office space, and misled his member firm as to whether any other businesses operated out of the branch office location.

The unregistered individual had been associated with a member firm and worked with the registered representative in years prior. He attempted to associate with the registered representative's firm, but the firm was unwilling to allow him to associate because of his disciplinary history. During a period of 16 months, the unregistered person conducted research and provided the registered representative with stock recommendations that the registered representative relayed to his own customers. In exchange for the stock recommendations, the registered representative paid the unregistered person approximately 40 percent of his brokerage commissions, totaling approximately \$255,000, without disclosing the commission payment arrangement to the member firm. FINRA found that that the representative's conduct violated NASD Rule [2420](#) (dealing with non-members) and FINRA Rule [2010](#) (ethical standards).

During this period, the registered representative also submitted a false and misleading compliance questionnaire to his member firm. On the questionnaire, the registered representative denied that any other businesses were located in the branch office when, in fact, the unregistered individual operated his business out of the same office. By signing and submitting an incorrect compliance questionnaire to the member firm, the registered representative caused the firm's books and records to be incorrect, and he concealed from the firm that the person it previously had rejected for association was in fact working out of firm office space. FINRA concluded that the registered representative's actions violated NASD Conduct Rule 3110⁷ (books and records) and FINRA Rule [2010](#) (ethical standards). In light of these violations, FINRA suspended the representative in all capacities for one year and fined him \$20,000.

Fraudulently Misappropriating Customer Funds

- ▶ FINRA settled a matter involving a registered representative who misled two customers to convince them to transfer approximately \$100,000, which the registered representative subsequently misappropriated. The registered representative fraudulently misrepresented to one customer that he would use the customer's money to purchase corporate bonds. In response, the customer transferred \$47,000 from his brokerage account to the registered representative. The registered representative deposited the funds into his personal bank account, used the money for personal expenses and never purchased the corporate bonds. The registered representative indicated to a second customer that he would use the customer's funds to purchase a certificate of deposit (CD). The customer transferred approximately \$53,000 to the registered representative for the purchase. The registered representative deposited the funds into his personal bank account and used the money to cover personal expenses. He did not purchase the CD.

FINRA found that the representative's conduct violated Section 10(b) of the Exchange Act (fraud); Exchange Act Rule 10b-5 (fraud); NASD Rules 2120^{''} (fraud), 2330(a)[†] (customers' securities or funds) and 2110[‡] (ethical standards), and FINRA Rules [2150\(a\)](#) (improper use of customer funds) and [2010](#) (ethical standards). In light of the registered representative's violations, FINRA barred him from associating with any firm in any capacity.

Recommending Unsuitable Transactions to a Customer

- ▶ FINRA settled a matter involving a registered representative who recommended unsuitable transactions to a customer. When the customer became the registered representative's client, she was a 53-year-old widow who worked as an administrative assistant for a public school system. Her annual salary was approximately \$55,000, she owned a home unencumbered by a mortgage and valued at approximately \$500,000, and she had an investment portfolio valued at approximately \$160,000 in retirement accounts and \$100,000 in certificates of deposit. The customer informed the registered representative that she intended to retire at age 60 with a pension and Social Security benefits. The registered representative prepared two proposed investment plans for the customer. One plan involved the customer taking a mortgage on her home, and the other did not. According to the registered representative's recommendations, the customer would earn more money if she mortgaged her home and invested the proceeds. Based on the registered representative's recommendation, the customer mortgaged her home. The representative referred the customer to an affiliate of his member firm to obtain a mortgage, assisted the customer in completing the paperwork for obtaining a mortgage and received a referral fee of \$1,225.

The customer obtained a fixed-rate loan in the amount of \$315,000 at 6.125 percent per year with a 30-year term and monthly payments of approximately \$1,900. Because closing costs were financed in the loan, the proceeds of the loan were somewhat less than \$311,000. The registered representative recommended that the customer invest \$300,000 of the proceeds in a variable annuity and further recommended certain fund allocations for the annuity. The representative received a commission of \$4,725 on the annuity purchase. At the time of the recommendations, the registered representative knew that the customer would have to mortgage her home to act in accordance with his recommendations, and that she could not pay the monthly mortgage payments without using her other investment assets.

FINRA found that the representative did not have a reasonable basis for recommending that the customer mortgage her primary residence to invest \$300,000 in a variable annuity, given that the customer intended to retire in seven years, had limited income, expected an equally limited retirement income and would have insufficient monthly income to make the mortgage payments. FINRA concluded that the registered representative's conduct violated NASD Rules 2110[†] (ethical standards) and 2310[#] (recommendations to customers), and IM-2310-2[#]. FINRA fined the representative \$5,000 and suspended him in all capacities for 10 business days.

Willfully Failing to Disclose Material Information on a Form U4

- ▶ FINRA settled a matter involving a registered representative who willfully failed to amend his Form U4 to disclose tax liens and judgments, and failed for six months to disclose a bankruptcy filing on his Form U4. During a five-year period, the Internal Revenue Service issued two federal tax liens against the registered representative, the representative entered into two agreed-upon tax judgments and a civil judge entered a judgment against the representative. The registered representative failed to disclose the federal tax lien and three judgments on the Form U4 that the representative filed while employed with a member firm for nearly 11 years, notwithstanding that on several occasions, the representative submitted attestations or reports, or met with firm auditors, and confirmed that he understood his obligations to report liens and judgments and that he had none to report.

While employed with the same member firm, the representative filed a voluntary petition for bankruptcy protection under Chapter 7 of the Bankruptcy Act. After filing the bankruptcy petition, the representative filed reports with the member firm, in which he attested that he understood his obligation to keep his Form U4 current, and the member firm reminded the representative of his obligation to report bankruptcy filings on the Form U4. The representative waited approximately six months to report his bankruptcy filing to his member firm and to amend his Form U4.

FINRA concluded that the representative's failures to disclose a federal tax lien, judgments, and a bankruptcy filing on the Form U4 were willful and violated Article V, Section 2(c) of NASD's and FINRA's By-Laws (applications for registration), NASD Rule 2110[†] (ethical standards) and FINRA Rule [2010](#) (ethical standards). As such, FINRA suspended the representative in all capacities for six months and fined him \$10,000.

Exercising Discretion Without Customer and Firm Approval

- ▶ FINRA settled a matter involving a registered representative who exercised discretionary authority in a customer account without the firm's and customer's approvals. During a two-day period, the registered representative exercised discretion in a customer's account by executing eight options transactions without having obtained the customer's prior written authority and the firm's prior approval. The representative's unauthorized discretionary trading resulted in losses for the customer in excess of \$480,000. FINRA found that this conduct violated NASD Rule [2510](#) (discretionary accounts) and FINRA Rule [2010](#) (ethical standards). In light of the foregoing violations, FINRA suspended the representative in all capacities for 30 business days and fined him \$5,000.

Improperly Engaging in Outside Business Activities, Improperly Accepting Gifts From a Customer, and Misrepresenting to a Member Firm the Receipt of Monetary Gifts From a Customer

- ▶ FINRA settled a matter involving a registered representative who improperly engaged in outside business activities, improperly accepted gifts from customers and misrepresented on firm questionnaires that he had received the gifts. Over the course of one year, the registered representative incorporated three separate organizations. For each, the representative filed articles of incorporation and annual reports, established a website, drafted website content and actively managed the entities' bank accounts. The first entity was a private equity group that the representative funded with \$90,000 from a customer. The second was an investment advisor for high-net-worth individuals that he also funded with \$184,000 from the same customer. The representative served as a principal and registered agent for both, and actively promoted their businesses. Although the representative did not receive compensation from either company, he used funds belonging to the private equity group to cover personal expenses and wrote checks totaling approximately \$25,000 from the advisory firm's accounts to himself, family members and cash. The third entity was a consulting group that provided consulting services to international companies for renewable energy projects and business development, and for which the representative filed articles of incorporation, established a website and prepared website content. The registered representative did not receive compensation from this entity. The representative did not disclose his outside business with the three entities on firm questionnaires.

The customer who funded the representative's outside business ventures had been the representative's customer for several years and was in his seventies. The customer did not have any children or other close family members. Over a period of three years, in addition to providing funding for the representative's outside businesses, the customer also gifted to the representative and his family members approximately \$1 million in cash and securities. The firm's policies and procedures prohibited representatives from accepting gifts and gratuities from customers. The representative failed to disclose his receipt of the gifts to his firm or to seek firm approval, and specifically misrepresented these facts on at least three compliance questionnaires. The representative also affirmatively misrepresented in compliance questionnaires that he had been named beneficiary on the customer's individual retirement account and four annuity policies, conduct which the firm's policies also prohibited. The registered representative also misrepresented on a firm questionnaire that he had arranged to receive mail at his home address that the firm sent to the customer. Furthermore, the representative misrepresented on a firm questionnaire that an address that he had provided for the customer was in fact one of the representative's outside business addresses, and that he was acting as the customer's power of attorney.

FINRA concluded that the registered representative's conduct violated NASD Rules 3030^s (outside business activities) and 2110^t (ethical standards), and FINRA Rule [2010](#) (ethical standards). FINRA suspended the representative from associating with any member firm in any capacity for eight months and fined him \$50,000.

Improperly Borrowing From a Customer and Misrepresenting Facts to a Member Firm

- ▶ FINRA settled a matter involving a registered representative who borrowed \$100,000 from a customer in violation of FINRA rules and without disclosing the arrangement to his member firm. The registered representative's loan from the customer was based on his personal relationship with the customer. The firm with which the registered representative was associated required that registered individuals receive prior written approval before accepting a loan from a customer based on a personal relationship. The representative failed to obtain prior written approval. The representative subsequently moved to a different firm. On a compliance questionnaire at the new firm, the representative falsely answered "no" to the question of whether he had ever borrowed money from a customer. The customer later complained about the representative's failure to abide by the loan repayment schedule, and the two later settled the matter. FINRA concluded that the representative's conduct violated NASD Rules 2370^x (borrowing from or lending to customers) and 2110^t (ethical standards), and FINRA Rule [2010](#) (ethical standards). FINRA suspended the registered representative from associating with any member firm in any capacity for six months and fined him \$7,500.

Selling Away

- ▶ FINRA settled a matter involving a registered representative who engaged in private securities transactions for compensation without providing his firm with advance notice or obtaining prior firm approval. The representative entered into a finder's fee agreement with a start-up company and solicited potential investors for the company. Six of the individuals whom the representative contacted purchased the company's shares for a combined total investment of \$650,000. For the investor referrals, the registered representative received \$65,000 in compensation from the company. The representative failed to provide his firm with prior written notice and obtain the firm's prior approval of his conduct. FINRA concluded that the representative's conduct violated NASD Rule [3040](#) (private securities transactions) and FINRA Rule [2010](#) (ethical standards). As such, FINRA suspended the registered representative in all capacities for nine months and fined him \$70,000, which included the disgorgement of the \$65,000 the representative received as a finder's fee.

* NASD Rule 3110 has been superseded by FINRA Rules [2268](#), [4511](#), [4512](#), [4513](#), [4514](#), [4515](#) and [7440](#), effective December 5, 2011.

** NASD Rule 2120 has been superseded by FINRA Rule [2020](#), effective December 15, 2008.

† NASD Rule 2330(a), (e) and (f) has been superseded by FINRA Rule [2150](#), effective December 14, 2009.

‡ NASD Rule 2110 has been superseded by FINRA Rule [2010](#), effective December 15, 2008.

NASD Rule 2310 and IM-2310-2 have been superseded by FINRA Rule [2111](#), effective July 9, 2012.

§ NASD Rule 3030 has been superseded by FINRA Rule [3270](#), effective December 15, 2010.

¥ NASD Rule 2370 has been superseded by FINRA Rule [3240](#), effective June 14, 2010.